

MOVING INTO THE NEW MILLENNIUM

ANNUAL INVESTMENT REPORT

YEAR ENDED JUNE 30, 1999



CALIFORNIA PUBLIC EMPLOYEES'

RETIREMENT SYSTEM

The California Public Employees' Retirement System (CalPERS) is the nation's largest public pension fund with assets at June 30, 1999 of approximately \$159.4 billion.

Headquartered in Sacramento, CalPERS provides retirement and health benefit services to more than 1.1 million people and more than 2,400 public employers. The System also operates eight offices located in San Francisco, Los Angeles, Orange County, Sacramento, San Bernardino, San Diego, Mountain View, and Fresno.

CalPERS is led by a 13-member Board of Administration, consisting of member-elected, appointed, and ex officio members.

Our membership consists of 816,512 active and inactive members from the State, school districts, and local public agencies, and 343,341 retirees, beneficiaries, and survivors.

Established by legislation in 1931, the System became operational in 1932 for State employees only. In 1939, other public agencies were allowed to contract with CalPERS to provide retirement benefits for their employees. We began administering health benefits to State employees in 1962 under the Public Employees' Medical and Hospital Care Act. Local public agencies joined in our health program on a contract basis five years later.



California Public Employees'
Retirement System

Annual Investment Report
Year Ended June 30, 1999



ANNUAL INVESTMENT REPORT

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INTRODUCTION

This report provides an overview of CalPERS investment performance and presents highlights and statistics of our investment programs and portfolios.

CalPERS earned a 12.5 percent return on investments for the one-year period ended June 30, 1999, marking the fifth straight year of double-digit returns. The Fund's total assets were valued at \$159.4 billion, growing approximately \$16.1 billion during the year, after contributions and benefit payments.

CalPERS investment performance was led by strong gains in equity investments. In total, approximately two-thirds of the System's assets — or 65 percent of the Fund — were invested in publicly-traded equities. The System's performance was well above the 8.25 percent assumed actuarial rate of return needed to pay benefits. We ranked in the top 25 percent of multi-billion public pension funds, according to a report compiled by the Trust Universe Comparison Service.

We continued to invest in the State of California, providing a strong economic boost for California's growth. At the end of the year, we had \$17.4 billion invested in California real estate, housing, and stocks and bonds in corporations that make California their home.

CalPERS BOARD OF ADMINISTRATION

William Dale Crist, President
Robert F. Carlson, Vice President
Philip Angelides
Willie Lewis Brown, Jr.
Kathleen Connell
Rob Feckner
Michael Flaherman
Sean Harrigan
Marty Morgenstern
Mike Quevedo, Jr.
William Rosenberg
Joseph A. Thomas
Charles P. Valdes

INVESTMENT COMMITTEE

All members of the Board serve on the Investment Committee. Michael Flaherman serves as the Committee Chair and Sean Harrigan is Vice Chair. This Committee reviews investment transactions, the work of staff and consultants, and establishes investment strategy and asset allocation.

CalPERS EXECUTIVE STAFF

James E. Burton
Chief Executive Officer
James H. Gomez
Deputy Executive Officer
Robert Aguallo
*Assistant Executive Officer
Investment Office*
Vincent P. Brown
*Assistant Executive Officer
Financial & Administrative Services*
Allen D. Feezor
*Assistant Executive Officer
Health Benefit Services*
Kayla J. Gillan
General Counsel
Barbara Hegdal
*Assistant Executive Officer
Member & Benefit Services*
Patricia K. Macht
Chief, Office of Public Affairs
Sheryl Pressler
*Chief Investment Officer
Investment Office*
Ron Seeling
*Chief Actuary
Actuarial & Employer Services*
Robert D. Walton
*Assistant Executive Officer
Governmental Affairs, Planning &
Research*

CONSULTANTS

Wilshire Associates
Pension Consultant
Pension Consulting Alliance/
Kenneth Leventhal & Co.
Real Estate Consultant
Hamilton Lane Advisors, Inc.
Pacific Corporate Advisors, Inc.
*Alternative Investment Management
Program*

CUSTODIAN

State Street Bank & Trust Company

MAINSTREAM DOMESTIC ACTIVE EQUITY MANAGERS

The Boston Company Asset
Management, L.L.C.
Brinson Partners, Inc.
Brown Capital Management, Inc.
Dresdner RCM Global Investors,
L.L.C.
Geewax, Terker & Company
Goldman Sachs Asset Management
Oak Associates, Ltd.
Oppenheimer Capital
The Putnam Advisory Company, Inc.

MAINSTREAM DOMESTIC PASSIVE EQUITY

Dimensional Fund Advisors, Inc.

SMALL & EMERGING DOMESTIC EQUITY

Valenzuela Capital
Partners, L.L.C.
ValueQuest/TA, L.L.C.

INTERNATIONAL FIXED INCOME MANAGERS

Baring International Investment,
Ltd.
Fiduciary Trust Company
International
Julius Baer Investment
Management, Inc.
Mercury Asset Management
International, Ltd.

GLOBAL ASSET ALLOCATION MANAGERS

Brinson Partners, Inc.

ACTIVE INTERNATIONAL EQUITY MANAGERS

Morgan Grenfell Investment
Services, Ltd.
Newport Pacific Management, Inc.
Nomura Asset Management U.S.A.,
Inc.
Oechsle International Advisors, L.P.
Paribas Asset Management, Inc.
Schroder Capital Management
International, Inc.
ValueQuest/TA, L.L.C.

PASSIVE INTERNATIONAL EQUITY MANAGERS

State Street Global Advisors

CURRENCY OVERLAY MANAGERS

Credit Suisse Asset Management
Pareto Partners
State Street Global Advisors

CORPORATE GOVERNANCE

Active Value Capital, L.P.
Hermes Lens Asset Management
Relational Investors, L.L.C.

REAL ESTATE ADVISORS & PARTNERS

AMB Institutional Realty Advisors,
Inc.
Amresco Advisors, Inc.
Bankers Trust Co.
Burnham Pacific Retail Properties
CNL Net Lease Investors, L.P.
Compass Management
Commonwealth Pacific
E&Y Kenneth Leventhal
GE Capital Investment Advisors,
Inc.
General Investment & Development
Advisors, Inc.
Hancock Timber Resource Group
Hearthstone Housing Partners, L.P.
Hines
Institutional Housing Partners, L.P.
Kennedy Associates Real Estate
Counsel, Inc.
LaSalle Advisors Capital
Management, Inc.
Lend Lease Real Estate Investments,
Inc.
MacFarlane Partners
Newland Capital Advisors
Olympic Realty Advisors
PICAL, L.P.
Prudential Home Building
Investors, Inc.
RREEF
Residential R.E. Partners, L.P.
Sentinel Real Estate Corporation
SSR Realty Advisors
The Newland Group, Inc.
Westmark Realty Advisors
Wells Fargo Housing Advisors, Inc.
Weyerhaeuser Corporation
W.P. Carey & Co., Inc.

YEAR ENDED JUNE 30, 1999

SUMMARY OF INVESTMENTS

Category	Book Value	Market Value	% of Investments at Market Value
Cash Equivalents & Net Receivables/Payables			
Domestic Cash Equivalents			
Internal Domestic Cash Equivalents			
Cash Equivalents	\$1,497,885,540	\$1,497,885,540	0.94%
State Pooled Money Investment Fund	423,449,000	423,449,000	0.27%
Total Internal Domestic Cash Equivalents	\$1,921,334,540	\$1,921,334,540	1.21%
External Domestic Cash Equivalents	\$52,046,681	\$52,046,681	0.03%
Total Domestic Cash Equivalents	\$1,973,381,221	\$1,973,381,221	1.24%
External International Currency	\$31,699,170	\$31,726,925	0.02%
Net Investment Receivables/Payables	\$1,139,743,759	\$1,139,743,759	0.72%
Total Cash Equivalents & Net Receivables/Payables	\$3,144,824,150	\$3,144,851,905	1.98%
Fixed Income			
Domestic Fixed Income			
Internal Domestic Fixed Income			
U.S. Treasuries & Other Fixed Income Securities			
U.S. Treasuries & Agencies	\$4,811,721,371	\$4,772,926,030	2.99%
Inflation Protected Securities	567,882,067	553,681,769	0.35%
Corporate			
Private	492,311,904	526,459,006	0.33%
Public	10,142,873,611	10,217,897,709	6.41%
Other Fixed Income	80,568,401	80,450,138	0.05%
International			
U.S. Treasuries & Agencies	66,477,526	66,926,265	0.04%
Public	373,654,079	363,533,286	0.23%
Sovereign	795,138,556	862,864,329	0.54%
Total U.S. Treasuries & Other Fixed Income Securities	\$17,330,627,515	\$17,444,738,532	10.94%
Mortgage-Backed Securities			
CMO	\$9,746,831,224	\$9,894,209,788	6.21%
FHLMC	2,689,347,759	2,616,626,088	1.64%
FNMA	2,388,973,041	2,348,272,579	1.47%
GNMA	669,072,215	646,971,584	0.41%
Total Mortgage-Backed Securities	\$15,494,224,239	\$15,506,080,039	9.73%
Private Mortgages			
Commercial Mortgage Pools	\$156,731,149	\$149,511,399	0.09%
Commercial Whole Loans	1,144,522,948	1,194,614,878	0.75%
Single Family Participating Certificates	850,865	961,490	0.00%
Total Private Mortgages	\$1,302,104,962	\$1,345,087,767	0.84%

SUMMARY OF INVESTMENTS (continued)

Category	Book Value	Market Value	% of Investments at Market Value
Special Investments			
Member Home Loan Programs			
FNMA (Deliverables)	\$655,527,349	\$614,130,611	0.39%
FNMA (Non-Deliverables)	160,340,493	160,242,571	0.10%
GNMA (Variable)	9,559,440	9,675,030	0.01%
GNMA (Fixed)	22,140,324	21,054,151	0.01%
Jumbo	164,539,493	164,721,618	0.10%
Retirement Account Loans	40,967,939	40,967,939	0.03%
Retirement Account Loans Defaulted	1,032,721	1,032,721	0.00%
AFL-CIO HIT	88,901,186	88,233,360	0.06%
Bridge Housing	12,192,138	12,192,138	0.01%
Equitable CCMF	34,615,208	35,214,965	0.02%
ULLICO	62,270,849	63,041,740	0.04%
Total Special Investments	\$1,252,087,140	\$1,210,506,844	0.77%
Total Internal Domestic Fixed Income	\$35,379,043,856	\$35,506,413,182	22.28%
External Domestic Fixed Income			
U.S. Treasuries & Agencies	\$532,559,095	\$519,074,584	0.33%
Various Fixed Income	24,631,204	22,175,330	0.01%
Total External Domestic Fixed Income	\$557,190,299	\$541,249,914	0.34%
Total Domestic Fixed Income	\$35,936,234,155	\$36,047,663,096	22.62%
External International Fixed Income	\$5,557,696,235	\$5,261,798,248	3.30%
Total Fixed Income	\$41,493,930,390	\$41,309,461,344	25.92%
Equity			
Domestic Equity			
Internal Domestic Equity			
Index Fund			
Common Stock	\$16,112,891,896	\$55,870,403,116	35.05%
International	108,665,873	469,645,276	0.29%
Preferred Stock	3,771,247	3,436,517	0.00%
Total Index Fund	\$16,225,329,016	\$56,343,484,909	35.34%
Other Internal Funds			
Common Stock	\$3,979,054,597	\$4,616,291,291	2.90%
International	30,837,911	47,685,868	0.03%
Preferred Stock	214,950	—	0.00%
Total Other Internal Funds	\$4,010,107,458	\$4,663,977,159	2.93%
Convertible Securities			
Bonds	\$232,180,486	\$248,948,243	0.16%
Other Funds	200,059,833	233,271,240	0.15%
Total Convertible Securities	\$432,240,319	\$482,219,483	0.31%
Total Internal Domestic Equity	\$20,667,676,793	\$61,489,681,551	38.58%
External Domestic Equity			
Common Stock	\$9,901,961,271	\$12,182,999,240	7.64%
International	321,115,800	368,600,773	0.23%
Convertible Bonds	2,512,500	2,778,916	0.00%
Total External Domestic Equity	\$10,225,589,571	\$12,554,378,929	7.87%
Total Domestic Equity	\$30,893,266,364	\$74,044,060,480	46.45%

YEAR ENDED JUNE 30, 1999

SUMMARY OF INVESTMENTS (continued)

Category	Book Value	Market Value	% of Investments at Market Value
External International Equity			
Common Stock - Unhedged	\$10,061,210,752	\$14,058,883,040	8.82%
Common Stock - Hedged	11,025,610,247	14,251,300,798	8.94%
Currency Options	23,538,054	6,575,715	0.00%
Total External International Equity	\$21,110,359,053	\$28,316,759,553	17.76%
Alternative Investment Management Program			
Private Equity			
Co-Investments	\$232,485,997	\$160,086,293	0.10%
Direct Investments	368,749,955	677,887,399	0.43%
Limited Partnership			
Domestic	3,415,564,166	3,834,199,758	2.41%
International	148,228,334	101,844,485	0.06%
Total Alternative Investment Management Program	\$4,165,028,452	\$4,774,017,935	3.00%
Total Equity	\$56,168,653,869	\$107,134,837,968	67.21%
Real Estate Programs			
Core Real Estate Investments			
Real Estate Equities	\$3,872,319,339	\$3,596,109,214	2.26%
Real Estate Joint Ventures	1,460,035,595	1,306,542,605	0.82%
Commercial Mortgages	14,807,883	22,355,052	0.01%
Sale/Leaseback	85,707,417	85,707,417	0.05%
Other Mortgages/AFL-CIO Building	50,131,384	81,642,155	0.05%
Real Estate Investment Trusts	524,263,146	551,099,496	0.35%
Total Core Real Estate Investments	\$6,007,264,764	\$5,643,455,939	3.54%
Specialized Real Estate Investments			
Single Family Land Acquisition & Development Program	\$81,845,889	\$64,424,219	0.04%
Single Family Housing Program	295,683,077	295,683,077	0.19%
Cadillac Fairview	234,603,165	10,700,521	0.01%
Catellus Common Stock	258,447,271	286,429,313	0.18%
California Urban Investment Program	13,696,305	13,696,305	0.01%
Franchise Finance	132,078,890	143,980,023	0.09%
Hotel	38,755,414	38,952,063	0.02%
Kennedy Development	24,209,232	24,209,232	0.02%
Land	10,072,342	8,355,233	0.01%
Security Capital Global Realty	72,500,000	68,983,750	0.04%
Timberland	429,219,439	1,198,498,280	0.74%
Total Specialized Real Estate Investments	\$1,591,111,024	\$2,153,912,016	1.35%
Total Real Estate Programs	\$7,598,375,788	\$7,797,367,955	4.90%
Total Investment Value	\$108,405,784,197	\$159,386,519,172	100.00%
Investment In R Street Project	\$9,822,270	\$9,822,270	
Total Investment Value	\$108,415,606,467	\$159,396,341,442	

NOTES:

Differences between Investment Values in the Summary of Investments and Asset Allocation Values shown on page 15 are due to differences in reporting methods. The Summary of Investments includes Net Investment Receivables/Payables.

P O R T F O L I O O F C A L I F O R N I A I N V E S T M E N T S

(Dollars in Millions)

Asset Class	CalPERS Total Portfolio	California Investments	California Investments % of Each Portfolio & Asset Class
Real Estate			
Mortgages			
AFL-CIO Housing Investment Trust	\$88.2	\$3.0	3%
Bridge Housing Construction	12.2	12.2	100%
Commercial (Whole Loans/Mortgage-Backed Securities)	1,345.1	306.5	23%
Equitable Community Mortgage Fund	35.2	35.3	100%
Member Home Loan Program	206.7	206.1	100%
ULLICO	63.0	63.0	100%
Total Real Estate Mortgages	\$1,750.4	\$626.1	36%
Equity			
Acquisition & Development Program	\$64.4	\$64.4	100%
AFL-CIO Building Investment Trust	81.6	—	25%
Bay Area Real Estate (Catellus)	286.4	232.0	81%
CNL Net Lease Program	144.0	23.04	16%
CUIP	13.70	13.7	100%
Equity	5,619.8	1,461.15	26%
Housing Development	295.7	295.6	100%
Kennedy	24.2	9.2	38%
Timber	1,198.5	0.6	0%
Security Cap Global	69.0	—	0%
Total Real Estate Equity	\$7,797.3	\$2,099.7	27%
Total Real Estate Mortgages & Equity	\$9,547.7	\$2,725.8	29%
Equities			
Alternative Investment Management Program			
Direct Component	\$838.0	\$47.0	6%
Partnership Component	3,936.0	976.0	25%
Domestic Equity	74,044.1	9,329.5	13%
International Equity	28,316.8	—	0%
Total Equities	\$107,134.9	\$10,352.5	10%
Total Real Estate & Equities	\$116,682.6	\$13,078.3	11%
Domestic Fixed Income			
Cash Equivalents & Receivables	\$3,113.2	\$ —	0%
International Currency	31.7	—	0%
Corporate Bonds	12,604.9	504.2	4%
Member Home Loan Program - FNMA/GNMA	805.1	805.1	100%
Mortgage Pass-Through CMO's	15,506.1	3,036.5	20%
Treasury Bonds	4,839.9	—	0%
Total Domestic Fixed Income	\$36,900.9	\$4,345.8	12%
International Fixed Income	\$5,803.0	\$ —	0%
Total Fixed Income	\$42,703.9	\$4,345.8	11%
Total Investments	\$159,386.5	\$17,424.1¹	11%

NOTES:

¹ Approximately \$18 billion has been committed for investment in California. The \$17.4 billion amount shown here represents investments to date.

INVESTMENTS

ANOTHER BANNER YEAR

The CalPERS investment portfolio continued to post healthy gains during the 1998-99 fiscal year. The Fund's total investment portfolio market value at June 30, 1999 was approximately \$159.4 billion, growing by \$16.1 billion during the year, after contributions and benefit payments. The System earned a 12.5 percent return on investments, marking the fifth straight year of double digit returns since the CalPERS Board voted to invest more of the System's assets in the U.S. and international equity markets. This performance was exceptional given the complexities of the global markets.

The System's strong investment performance was led by gains in its equity investments. In total, approximately two-thirds of the System's assets — or 65 percent of the Fund — were invested in publicly-traded equities. CalPERS U.S. stocks returned 20.7 percent, beating the 20.3 percent return earned by the Fund's benchmark the Wilshire 2500. The System's international stocks returned 8.7 percent, compared to a benchmark return of 8.5 percent.

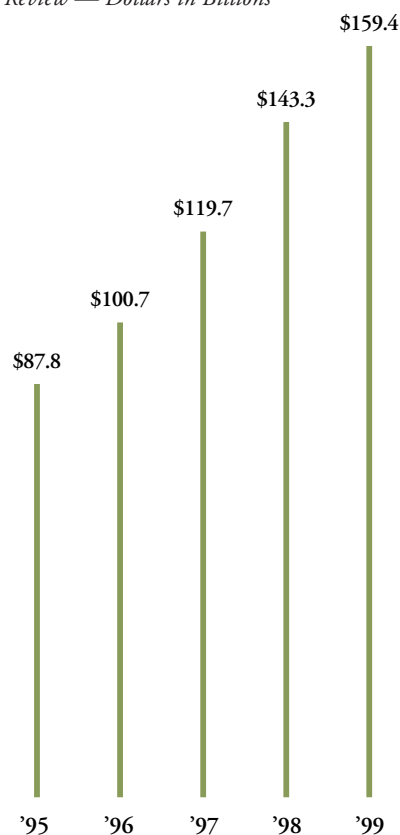
Diversification in other assets classes helped to preserve gains in the investment portfolio and served as our insurance policy against dips in the equity market. Several of the System's asset classes posted healthy returns.

CalPERS limited partnership investments earned more than 13.5 percent, while the Fund's private equity investments gained 17 percent. Total fixed income investments earned a 1.8 percent return versus the Fund's benchmark of 2.0 percent. Our internally managed U.S. fixed income investments beat their benchmark during the period when the U.S. bond markets fell victim to rising domestic interest rates.

CalPERS U.S. fixed income investments earned a 1.6 percent return outpacing the Salomon Brothers Large Pension Fund Index return of 1.3 percent, while our international bonds gained 2.6 percent versus the Salomon Brothers Non-U.S. Government Index of 4.9 percent.

GROWTH OF INVESTMENT PORTFOLIO MARKET VALUE

Five-Year Review — Dollars in Billions



CORPORATE GOVERNANCE

The year also marked the 12th anniversary of the CalPERS U.S. and international corporate governance program. During the proxy season, CalPERS issued its “Focus List” of Corporate America’s poorest performers. The companies included Tyson Foods, Circus Circus, Cummins Engine, Pacific Century Financial, Pioneer Natural Resources, Sierra Health, St. Jude Medical, Mallinckrodt and National Semiconductor. CalPERS pushed a variety of corporate governance improvements at these companies in an effort to generate better returns and long-term growth. Several companies escaped greater pressure from CalPERS by agreeing to institute several shareowner protective changes, including such things as adopting independent directors and audit committees, eliminating poison pills, and adopting CalPERS’ definition of an independent director.

To improve the lines of communication between investors and corporations, CalPERS launched a new web site dedicated to advancing good corporate governance in the world’s financial markets. The new site — CalPERS Shareowner Forum — provides breaking news on CalPERS corporate governance activities and proxy voting decisions in time for companies’ annual meetings. The site also provides

information on CalPERS shareholder litigation activities, criteria for selecting its annual list of corporate governance focus companies, full text of the System’s U.S. and international corporate governance principles and a library of over 14,000 abstracts of interdisciplinary studies, essays, reports, and papers on corporate governance global issues, trends and views.

1999 CORPORATE GOVERNANCE

Focus Companies

Cummins Engine	Mallinckrodt
Pacific Century Financial Corporation	National Semiconductor
Pioneer Natural Resources	Circus Circus
Sierra Health	Tyson Foods
St. Jude Medical	

TOTAL FUND PERFORMANCE

10-Year Review — One-Year Returns



On the international front, CalPERS joined forces with Hermes, the investment manager for two major pension schemes in the United Kingdom. The transcontinental corporate governance alliance provides that CalPERS and Hermes each endorse the other's home market corporate governance proxy voting policies and generally vote their proxies in accordance with those policies. Additionally, the two large institutional investors vowed to work cooperatively and represent each other in their respective markets, including at annual shareholder meetings. The combined power of CalPERS and Hermes is expected to mean greater shareowner pressure on companies in the U.S. and United Kingdom.

Recognizing that the Year 2000 computer bug could impact the world's markets, CalPERS wrote to more than 1,600 companies in the Fund's equity portfolio calling on them to fulfill their obligations to investors and comply with the Year 2000 disclosure requirements adopted by the U.S. Securities and Exchange Commission. CalPERS went one step further in the international arena and issued a survey to some 2,600 non-U.S. corporations to determine their state of readiness for the year 2000. Corporations were asked to provide information on compliance certificates, the status of renovating and testing the company's mission critical systems, and their contingency plans.

LEAD INDEPENDENT DIRECTOR POSITION DUTY STATEMENT

The chief executive officer is the senior executive of the Company. The CEO is responsible for:

- providing management of the day-to-day operations of the Company;
- recommending policy and strategic direction of the Company, for ultimate approval by the Board of Directors; and
- acting as the spokesperson of the Company.

In contrast, the Lead Independent Director is responsible for coordinating the activities of the independent directors. In addition to the duties of all Board members as set forth in the Company's [Governance Guidelines], the specific responsibilities of the Lead Independent Director are as follows:

- advise the Chair as to an appropriate schedule of Board meetings, seeking to ensure that the independent directors can perform their duties responsibly while not interfering with the flow of Company operations;
- provide the Chair with input as to the preparation of the agendas for the Board and Committee meetings;
- advise the Chair as to the quality, quantity, and timeliness of the flow of information from Company management that is necessary for the independent directors to effectively and responsibly perform

their duties; although Company management is responsible for the preparation of materials for the Board;

- the Lead Independent Director may specifically request the inclusion of certain material;
- recommend to the Chair the retention of consultants who report directly to the Board; interview, along with the chair of the [nominating committee], all Board candidates, and make recommendations to the [nominating committee] and the Board;
- assist the Board and Company officers in assuring compliance with and implementation of the Company's [Governance Guidelines]; principally responsible for recommending revisions to the [Governance Guidelines];
- coordinate and develop the agenda for and moderate executive sessions of the Board's independent directors; act as principal liaison between the independent directors and the Chair on sensitive issues;
- evaluate, along with the members of the [compensation committee/full board], the CEO's performance; meet with the CEO to discuss the Board's evaluation; and
- recommend to the Chair the membership of the various Board Committees, as well as selection of the Committee chairs.

LOW COST INVESTOR

CalPERS continued to be a value-added leader in managing its investments assets at a low cost. According to a study issued by Cost Effectiveness Measures, Inc., investment decisions earned the System an extra \$2 billion over and above the Fund's projected returns. CalPERS value-added performance exceeded 91 percent of other large public and private pension funds, and did so at a lower cost. While CalPERS spent \$124 million for consultants, internal management and external managers, it amounted to only one-tenth of one percent of the Fund's value. The System's costs were far less than other large multi-billion dollar pension funds, whose median costs were nearly 48 percent higher.

The study concluded that CalPERS investment expenses were low because we continued to manage the bulk of our equity investments passively and chose to manage these assets, and our fixed income portfolio, internally through CalPERS staff rather than external advisors. Even CalPERS expenses in typically high cost areas such as real estate and alternative investments were well below the Fund's peers.

CALPERS DEFINITION OF AN INDEPENDENT DIRECTOR

An "Independent Director" means a director who:

- has not been employed by the Company in an executive capacity within the last five years;
- is not, and is not affiliated with a company that is, an adviser or consultant to the Company or a member of the Company's senior management;
- is not affiliated with a significant customer or supplier of the Company;
- has no personal services contract(s) with the Company, or a member of the Company's senior management;
- is not affiliated with a not-for-profit entity that receives significant contributions from the Company;
- within the last five years, has not had any business relationship with the Company (other than service as a director) for which the Company has been required to make disclosure under Regulation S-K of the Securities and Exchange Commission;
- is not employed by a public company at which an executive officer of the Company serves as a director;
- has not had any of the relationships described above with any affiliate of the Company; and
- is not a member of the immediate family of any person described above.

INVESTMENT POLICY & STRATEGY

The CalPERS Board has investment authority and sole responsibility for the management of assets. They decide how the assets are allocated and make the investment decisions that staff implement on a daily basis. Every month, the Board receives reports on performance, transactions, manager reviews, cash flow estimates, activity deal flow, and partnership and manager selections in order to monitor asset classes. Once a year, the Board participates in an asset liability management workshop to review the asset class targets, and meets in a special workshop to analyze factors important in determining the appropriate asset allocation. The health of the global financial markets, future liabilities of the System, and expected future contributions are analyzed.

CalPERS asset allocation is one of the most important policies and investment strategies set by the Board. It is essentially the starting point and most important component for CalPERS to achieve successful returns on investment. In the long run, it is the way the Fund diversifies stocks, bonds, cash, and other investments that is largely responsible for the System's returns.

There are two types of asset allocations: strategic and tactical. Strategic asset allocation is the basis for long-term asset allocation targets for each asset class. Within each asset class, ranges are included in the policy to provide the flexibility to take advantage of market opportunities. Information is received from staff, research services, and money managers. This forms the tactical asset allocation which allows shifts between classes to take advantage of emerging or rapid market opportunities.

In addition to CalPERS asset allocation policy, the Board established the following investment objectives for the portfolio. Investment policies are formally reviewed through the System's Investment Policy Subcommittee and receive final approval by the Investment Committee.

INFLATION

Achieve a total portfolio return of 4 percent in excess of the U.S. Consumer Price Index.

ACTUARIAL

Achieve a total portfolio return above the assumed actuarial interest rate, currently 8.25 percent for the period July 1, 1998 through June 30, 1999.

PERFORMANCE

1. For the internal equity index portfolio, achieve a return equal to the Wilshire 2500 Index, plus or minus 50 basis points.
2. For externally managed assets, meet specific performance objectives related to their investment style, which are outlined in their contract.
3. For internal domestic fixed income instruments, achieve a return in excess of the Salomon Brothers Large Pension Fund Index.
4. For equity real estate, achieve a least a 5 percent real rate of return.
5. For alternative and private equity investments, achieve an annual hurdle rate of 15 percent.

CalPERS ASSET ALLOCATION

As of June 30, 1999

ASSET CLASS	MARKET VALUE (\$ BILLION)	CURRENT ALLOCATION	TARGET
Cash Equivalents	2.2	1.4%	1.0%
Fixed Income			
Domestic	35.4	22.3	24.0
International	5.7	3.6	4.0
Total Fixed Income	43.3	27.3	29.0
Equities			
Domestic	73.6	46.2	41.0
International	29.9	18.8	20.0
Alt. Inv./Private Eq.	4.8	3.0	4.0
Total Equities	108.3	68.0	65.0
Real Estate	7.5	4.7	6.0
Total Fund	\$159.1	100.0%	100.0%

NOTES:

Differences between Investment Values above and Investment Values in the Summary of Investments on page 10 are due to differences in reporting methods. The Summary of Investments includes Net Investment Receivables/Payables.

CalPERS ASSET PERFORMANCE VS. BENCHMARK

As of June 30, 1999

ASSET CLASS	ASSET RETURN	BENCHMARK RETURN	BENCHMARK DESCRIPTION
Cash Equivalents	5.7%	5.2%	State Street Bank STIF
Fixed Income			
Domestic	1.6	1.3	Salomon Brothers Large Pension Fund Index
International	2.6	4.9	Salomon Brothers Non-\$ World Government Index
Total Fixed Income	1.8	2.0	Weighted benchmark based on current asset allocation target mix
Equities			
Domestic	20.7	20.3	Wilshire 2500
International	8.7	8.5	FT Actuaries/IFC Investable Index
Alt. Inv./Private Eq.	14.3	15.0	15% Annual Hurdle Rate
Total Equities	17.0	16.8	Weighted benchmark based on current asset allocation target mix
Real Estate	9.4	14.4	NCREIF Property Index
Total Fund	12.5%	12.7%	Weighted benchmark based on current asset allocation target mix

INVESTMENT PORTFOLIO

GLOBAL PUBLIC MARKETS

Public market investments represent the largest portion of our investment portfolio. More than \$107 billion was invested in the U.S. and international equity markets and \$41.3 billion invested in domestic and international fixed income at the end of the fiscal year.

Approximately \$56.3 billion of the Fund’s domestic equity assets are passively managed internally and \$1.5 billion are managed by one external small capitalization passive manager, while the remaining \$8.8 billion — are actively managed by external fund managers. The System’s \$35.8 billion domestic fixed income portfolio is managed internally, while all the Fund’s international equity and fixed income

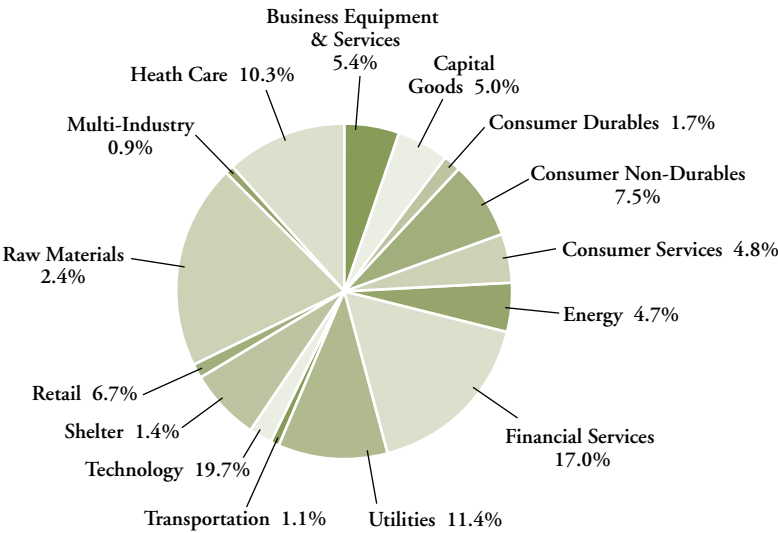
investments valued at \$33.5 billion are managed externally, using 13 investment managers.

During the year, the CalPERS Board approved a plan to actively manage up to \$2 billion of the Fund’s domestic stock investments in-house. Fund officials believe the benefits of internal active management, including increased diversification, lower costs, and flexible investment decisions will add value to the Fund. CalPERS began to fund several different strategies, such as enhanced index funds and synthetic index funds, in amounts ranging from \$200 million to \$500 million. Each strategy carries with it a unique portfolio construction and trading procedure.

CalPERS also embarked on a new innovative manager development program that focuses on the development

DOMESTIC EQUITY SECTOR DISTRIBUTION OF COMMON STOCK

Internally Managed Portfolios



FIXED INCOME INVESTMENTS

Dollars in Billions

	MARKET VALUE	% OF PORTFOLIO
Domestic	\$35.4	22.3%
International	5.7	3.6
Total	\$41.1	27.3%

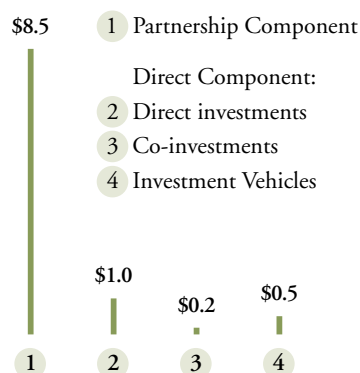
DOMESTIC EQUITY INVESTMENTS

Dollars in Billions

	MARKET VALUE	% OF PORTFOLIO
Internal Portfolios	\$61.4	38.6%
External Portfolios	12.1	7.6
Total	\$73.5	46.2%

ALTERNATIVE INVESTMENT MANAGEMENT PORTFOLIO SUMMARY

Committed Dollars in Billions



of new and emerging money managers. The goal of the program is to achieve superior investment returns while providing opportunities to new and emerging money managers that typically don't have the stature, investment performance track record, business expertise, and marketing clout to compete against larger, more established firms. The System committed up to \$4 billion to the new programs and selected two California-based firms to help implement the program.

Under the program, CalPERS provides assets for the new firms to invest, and may take an equity position in the firms to assist participating firms to grow. CalPERS and its two partners vowed also to provide emerging firms with assistance and support in business management, accounting, technology infrastructure, marketing, and other services that are needed to succeed. It is expected that as the firms grow and mature, CalPERS will realize profits from its equity positions when a firm goes public, or when a firm is bought out by larger established firms.

ALTERNATIVE INVESTMENT MANAGEMENT (AIM) PROGRAM

CalPERS commitments to partnership investments increased over the past three years, resulting in a majority of the portfolio being in the early stage of its investment life. At the end of the fiscal year, CalPERS had committed more than \$8.4 billion to 119 partnership investments, which posted a 21.2 percent return during the year.

Corporate restructuring and expansion capital strategies make up the largest percentage of commitments in the AIM program representing 56 percent, or \$5.5 billion. This was followed by venture capital which captured more than \$1 billion of the System's dollars.

CalPERS also continued to reserve a portion of its portfolio to direct investments. Market conditions require more selectivity and efficient and direct investments provided a foundation to find creative ways to put capital to work in the private equity market. The System committed approximately \$1.8 billion to 13 independently sourced direct investments, co-investments, and other investment vehicles. These earned a 15.5 percent return for the year.

INVESTMENT PORTFOLIO

Additionally, CalPERS continued to sharpen its focus on value-added investments that build businesses by targeting California investments that capitalize on the State’s strong economy and innovative technology sector. In October 1998, the System implemented a \$350 million California Emerging Ventures Program — a venture capital investment vehicle that will invest heavily in California. The Fund allows the System to tap the pace of technological change in California and help establish long-term relationships in the venture capital arena. At the end of the year, the program had successfully invested \$15.5 million which increased in value to more than \$16 million — a 26 percent return on investments.

Internationally, we sought out alternative investments that captured opportunities in recovering Asian markets. We invested \$175 million in two funds that make investments through acquisitions, spin-offs, restructuring, and corporations emerging from bankruptcies.

REAL ESTATE

Valuable opportunities in the real estate market were abundant during the year. CalPERS total real estate investment portfolio market value was more than \$7.8 billion, growing \$1.6 billion over last year. The majority of the portfolio included more than \$5.6 billion in apartment, retail, industrial, and office investments.

The dramatic growth in the System’s real estate portfolio occurred during the last few quarters of the fiscal year when REITS were sidelined with low stock prices. CalPERS snapped up more than \$1 billion in core real estate assets as REITS began to downsize and prune some of their assets. Nearly half — or \$518 million — of the properties purchased were California apartment, office, retail, and industrial buildings. More than 40 percent of the properties purchased by the Fund included grocery-anchored retail centers and industrial buildings, properties that are more resistant to downturns in the market.

The heavy acquisition activity followed on the heels of a two-year review of CalPERS real estate. The review sealed the selection and retention of core real estate advisers to manage the System’s apartments, office, industrial, and retail properties. Each firm co-invests significant equity with CalPERS and operates under a philosophy that is consistent with our investment objectives. The result is better, effective alignment of interests between management and CalPERS, and an environment where responsibility and accountability are crystal clear.

CaIPERS INTERNATIONAL INVESTMENTS

Up to \$25 million	New Zealand
China	Portugal
Cayman Islands	Singapore
Indonesia	Turkey
Luxembourg	
Thailand	\$300 – \$500 million
	Belgium
\$25 – \$50 million	Hong Kong
Austria	South Africa
Chile	
Korea	\$500 million – \$1 billion
Norway	Canada
Philippines	Sweden
	Spain
\$50 – \$100 million	
Argentina	More than \$1 billion
Brazil	Australia
Malaysia	European Currency Unit
Taiwan	France
	Germany
\$100 – \$300 million	Italy
Denmark	Japan
Finland	Netherlands
Greece	Switzerland
Ireland	United Kingdom
Mexico	

Additionally, we began to develop and implement strategies for the remaining \$2.2 billion in specialized real estate investments, devoted to assets such as timber, housing, land, and other specialized programs. We approved a new

strategic plan for timber investments and conducted a nationwide search for new investment firms to manage our \$1.2 billion in timberland. The plan also called for CalPERS to explore timberland investment outside the United States.

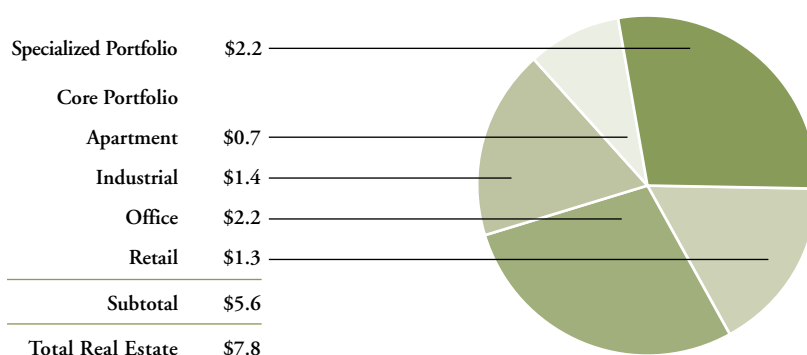
TOP 10 INTERNAL DOMESTIC EQUITY HOLDINGS

As of June 30, 1999

COMPANY	SHARES	MARKET VALUE
Microsoft Corporation	25,385,964	\$ 2,289,496,628
General Electric Co.	16,105,400	1,819,910,200
Cisco Systems Inc.	22,720,093	1,464,845,219
International Business Machines	9,583,050	1,238,609,212
Intel Corporation	18,011,492	1,071,683,774
Lucent Technologies Inc.	15,259,084	1,029,034,527
Wal Mart Stores Inc.	20,978,100	1,012,193,325
Citigroup Inc.	20,529,937	975,172,031
Exxon Mobile Corporation	11,962,700	922,623,237
Merck & Co. Inc.	12,433,968	919,177,119

TOTAL REAL ESTATE PORTFOLIO

Dollars in Billions



CALIFORNIA INVESTMENTS

CalPERS pumps nearly \$18 billion into California's economy through its equity investment, real estate holdings, home loan program, and other economic activity. We have become a critical part of the economic fabric of the State. From the San Francisco Bay Area, to the Central Coast, down to greater Los Angeles region, our investments help build houses, finance homes, and provide the money to pay thousands of private sector jobs.

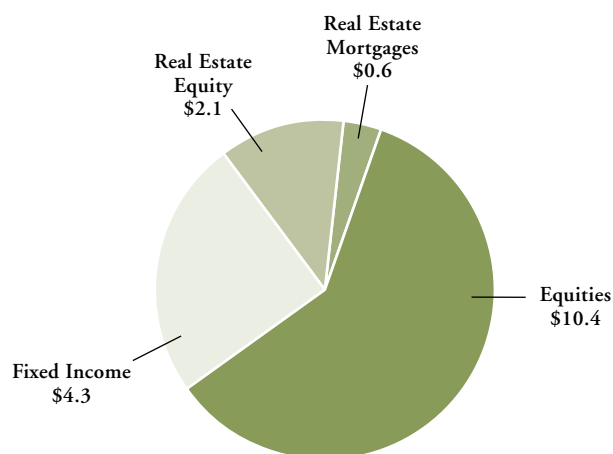
We invested more than \$10 billion in corporations that make their home in California or have operations in our

State. Our real estate holdings and mortgages finance \$2.7 billion worth of single family homes and general real estate holdings, while our fixed income assets, largely held in government and corporate bonds, amount to more than \$4.3 billion.

Fulfilling our commitment to seek out investments that strengthen California's economy, the Board invested approximately \$340 million in California community shopping centers in San Francisco, Los Angeles, San Diego, and Santa Barbara.

CalPERS CALIFORNIA INVESTMENTS

Dollars in Billions



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